

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name City of Cheboygan	County Cheboygan
Fiscal Year End June 30, 2006	Opinion Date September 7, 2006	Date Audit Report Submitted to State September 27, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

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Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Anderson, Tackman & Company, PLC		Telephone Number 906-495-5952	
Street Address 16978 S. Riley Avenue		City Kincheloe	State MI
Authorizing CPA Signature <i>Kenneth A. Talsma</i>		Printed Name Kenneth A. Talsma	Zip 49788
		License Number 1101024989	

CITY OF CHEBOYGAN, MICHIGAN

BASIC FINANCIAL STATEMENTS

June 30, 2006

CITY OF CHEBOYGAN, MICHIGAN

ORGANIZATION

MEMBERS OF THE CITY COUNCIL

MAYOR	JAMES E. MUSCHELL
MAYOR PRO TEM	SCOTT M. MCCAUSLIN
COUNCILMAN	GERALD BOARDMAN
COUNCILMAN	WILLIAM E. CHLOPAN
COUNCILMAN	CHARLES CHARBONEAU
COUNCILMAN	WINIFRED L. RIDDLE
COUNCILMAN	LESLIE A TEBO

APPOINTED OFFICERS

CITY MANAGER	SCOTT E. MCNEIL
CLERK/TREASURER	KENNETH J. KWIATKOWSKI

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REPORTS ON COMPLIANCE

Report on Internal Control Over Financial Reporting and
on Compliance and Other Matters Based on an Audit
of Financial Statements Performed in Accordance
with *Government Auditing Standards* 48



ANDERSON, TACKMAN & COMPANY, PLC
CERTIFIED PUBLIC ACCOUNTANTS

KINROSS OFFICE

PHILLIP J. WOLF, CPA, PRINCIPAL
SUE A. BOWLBY, CPA, PRINCIPAL
KENNETH A. TALSMAN, CPA, PRINCIPAL

DEANNA J. MAYER, CPA

MEMBER AICPA
DIVISION FOR CPA FIRMS

MEMBER MACPA

OFFICES IN
MICHIGAN & WISCONSIN

INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Members
of the City Council
City of Cheboygan, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Cheboygan, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the City of Cheboygan, Michigan's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely present component unit, each major fund, and the aggregate remaining fund information of the City of Cheboygan, Michigan as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2006 on our consideration of the City of Cheboygan, Michigan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Cheboygan, Michigan's basic financial statements. The accompanying supplemental information such as the combining nonmajor fund financial statements identified in the table of contents, is presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to basic financial statements taken as a whole.



Anderson, Tackman & Company, PLC
Certified Public Accountants

September 7, 2006

Management's Discussion and Analysis

As management of the City of Cheboygan, Michigan (the "City"), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the financial statements and notes to the financial statements.

Financial Highlights

- The assets of the City exceeded its liabilities at the close of the fiscal year 2006 by \$14,446,194 (*net assets*). Of this, \$1,887,525 (*unrestricted net assets*) may be used to meet the City's ongoing obligations to citizens and creditors.
- The City completed construction on the \$1,350,000 addition to the Department of Public Safety building. Among the improvements are an interrogation room, showers, additional office and conference space, and in-door parking for police and fire vehicles.
- The City set aside funds which cover the future cost of retiree Blue Cross and the payment of sick and vacation time accruals at the time of retirement. The Retiree BC/BS Investment Fund and Termination Liability Fund had balances of \$240,539 and \$106,544, respectively as of June 30, 2006.
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$494,774 or 17% of the total General Fund expenditures and transfers.
- The City will be receiving approximately \$5,000,000 in funding from the Michigan Department of Transportation to replace the Lincoln Avenue Bridge.
- The City is near completion of \$632,600 in improvements to the riverfront at the Major City Park. The project is being funded through grants in the amount of \$546,900 from the Michigan Dept. of Natural Resources and the Great Lakes Fisheries Trust Fund. The balance is being funded from the City's General Fund Balance. Among the improvements are river bank stabilization (rip-rap), additional fishing piers and lighted pathways.
- The City completed an Energy Upgrade Project in the amount of \$345,000. Significant savings in energy costs are expected at the upgraded facilities, the main savings will be realized at the City Hall facility.
- The City issued 2006 Refunding Bonds in the amount of \$2,705,000 to retire its' 1997 Water/Sewer Upgrade Bonds. The average interest rate on the 1997 Water/Sewer Upgrade Bonds was 6.25%. The average interest rate on the 2006 Refunding Bonds is 3.805%, resulting in significant savings to the City tax payers.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This report also contains other supplementary information in addition to the financial statements themselves.

Government-wide financial statements. The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statements of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave and accrued interest expense).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include legislative, general government, public safety, public works and culture and recreation. The business-type activities include the sewer and water activities.

The government-wide financial statements include not only the City itself (known as the *primary government*), but also the Cheboygan Downtown Development Authority, a legally separate component unit for which the City is financially accountable.

The government-wide financial statements can be found on pages 12–13 of this report.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objective. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as *on balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of *governmental funds* is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains 21 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Major Street Fund, Local Street Fund, 2000 Streetscape Special Assessment Bond Fund and 2004 General Obligation Bond Construction Fund, each of which are considered to be major funds. Data from the other 16 governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual appropriated budget for its General and Special Revenue Funds. Budgetary comparison statements have been provided herein to demonstrate compliance with the General Fund and the major Special Revenue Funds.

The basic *governmental fund* financial statements can be found on pages 14-15 of this report.

Proprietary funds. The City maintains two different types of proprietary funds. *Enterprise Funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses Enterprise Funds to account for its sewer and water operations. *Internal Service Funds* are an accounting device used to accumulate and allocate costs internally among the various City functions. The City of Cheboygan uses its Internal Service Fund to account for its motor pool activities.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the sewer and water departments which are considered major enterprise funds of the City.

The basic proprietary fund financial statements can be found on 17-19 of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for governmental funds.

The basic fiduciary fund financial statement can be found on page 20 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 21-38 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain supplementary information including the combining statements referred to earlier in connection with nonmajor governmental funds which are presented immediately following the notes to the financial statements. Combining and individual fund statements and schedules can be found on pages 39-47 of this report.

Government-wide Financial Analysis

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$14,446,194 at the close of fiscal year 2006.

Approximately 84% of the City's net assets reflect its investment in net capital assets (e.g., land, buildings, water, and sewer systems, vehicles, and equipment); less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. Net assets restricted for debt service, capital projects and perpetual care represent approximately 3% of total net assets. The remaining balance of unrestricted net assets (\$1,887,525) may be used to meet the government's ongoing obligation to citizens and creditors.

City of Cheboygan Condensed Statement of Net Assets

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Assets						
Cash and other assets	\$ 1,742,643	\$ 2,958,271	\$ 1,099,789	\$ 1,078,464	\$ 2,842,432	\$ 4,036,735
Capital assets, net of accumulated depreciation, where applicable	<u>9,480,958</u>	<u>7,931,324</u>	<u>9,590,394</u>	<u>9,777,634</u>	<u>19,071,352</u>	<u>17,708,958</u>
Total assets	<u>11,223,601</u>	<u>10,889,595</u>	<u>10,690,183</u>	<u>10,856,098</u>	<u>21,913,784</u>	<u>21,745,693</u>
Liabilities						
Current and other liabilities	494,656	565,045	46,308	110,302	540,964	675,347
Long-term debt, net of current portion	<u>6,926,626</u>	<u>6,835,848</u>	<u>-</u>	<u>-</u>	<u>6,926,626</u>	<u>6,835,848</u>
Total liabilities	<u>7,421,282</u>	<u>7,400,893</u>	<u>46,308</u>	<u>110,302</u>	<u>7,467,590</u>	<u>7,511,195</u>
Net assets						
Invested in capital assets, net of related debt	2,507,459	996,356	9,590,394	9,777,634	12,097,853	10,773,990
Restricted	460,816	1,737,292	-	-	460,816	1,737,292
Unrestricted	<u>834,044</u>	<u>755,054</u>	<u>1,053,481</u>	<u>968,162</u>	<u>1,887,525</u>	<u>1,723,216</u>
Total Net Assets	<u>\$ 3,802,319</u>	<u>\$ 3,488,702</u>	<u>\$ 10,643,875</u>	<u>\$ 10,745,796</u>	<u>\$ 14,446,194</u>	<u>\$ 14,234,498</u>

At the end of the current fiscal year, the City is able to report positive balances in all three categories of net assets, for the government as a whole and for its separate governmental and business-type activities.

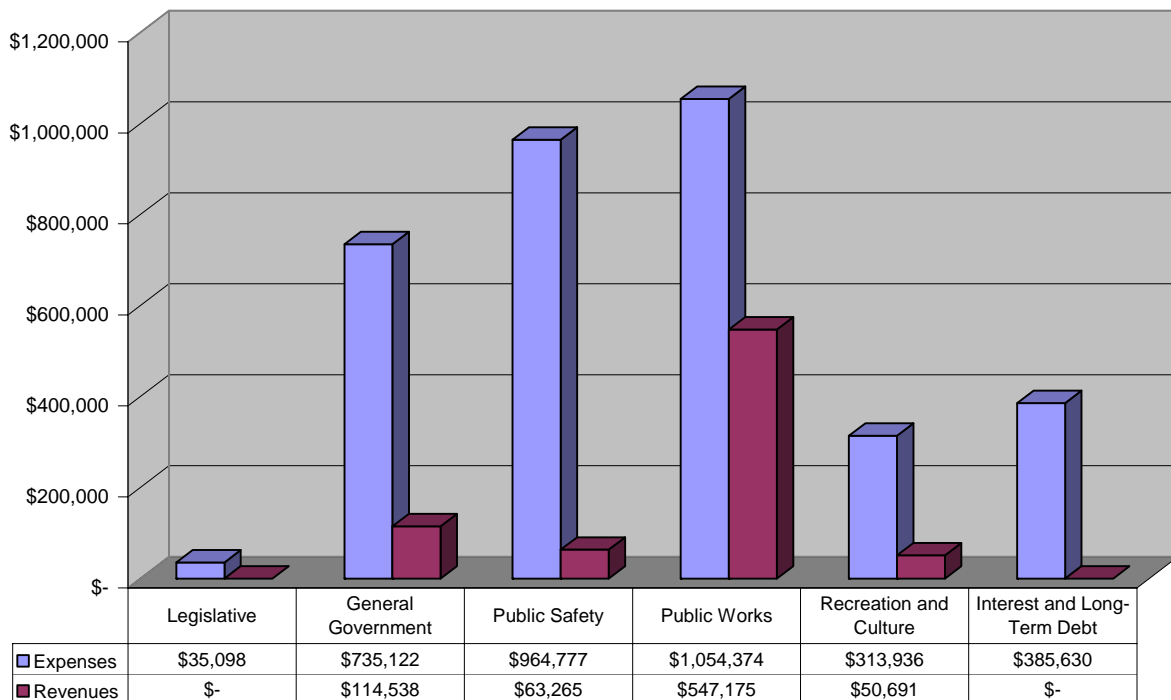
The City's net assets increased \$211,696 during the current fiscal year.

**City of Cheboygan
Condensed Statement of Changes in Net Assets**

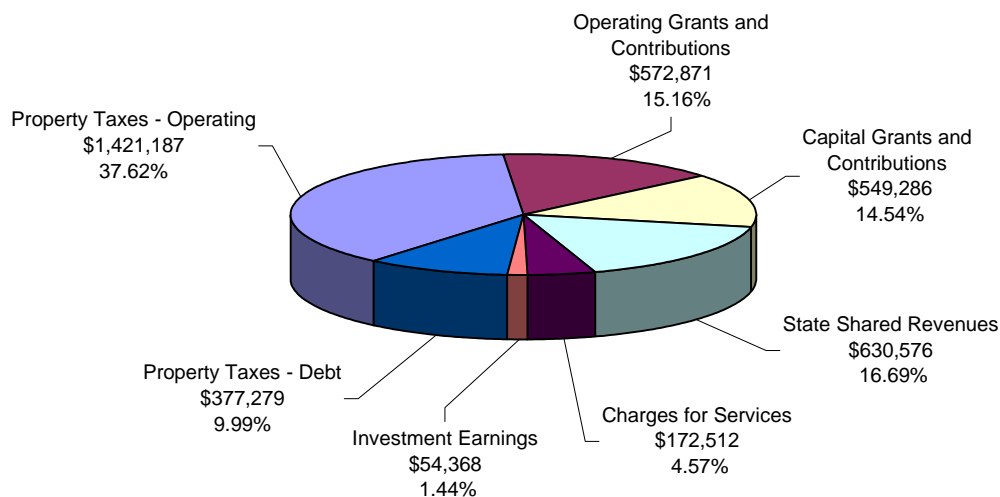
	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenues						
Program revenues						
Charges for services	\$ 172,512	\$ 118,358	\$ 1,332,513	\$ 1,186,451	\$ 1,505,025	\$ 1,304,809
Operating grants and contributions	572,871	695,193	-	44,826	572,871	740,019
Capital grants and contributions	549,286	-	-	-	549,286	-
General revenue						
Property taxes –						
General operating	1,421,187	1,421,711	-	-	1,421,187	1,421,711
Property taxes – debt	377,279	436,411	-	-	377,279	436,411
State shared revenues	630,576	639,001	-	-	630,576	639,001
Interest earnings	54,368	35,297	18,510	7,486	72,878	42,783
Local contributions	-	125,760	-	-	-	125,760
Transfers	24,475	30,175	(24,475)	(30,175)	-	-
Total revenues	3,802,554	3,501,906	1,326,548	1,208,588	5,129,102	4,710,494
Expenses						
Legislative	35,098	58,732	-	-	35,098	58,732
General government	735,122	738,232	-	-	735,122	738,232
Public safety	964,777	893,131	-	-	964,777	893,131
Public works	1,054,374	937,765	-	-	1,054,374	937,765
Recreation and culture	313,936	296,970	-	-	313,936	296,970
Sewer	-	-	936,955	906,612	936,955	906,612
Water	-	-	491,514	533,275	491,514	533,275
Interest on long-term debt	385,630	372,439	-	-	385,630	372,439
Total expenses	3,488,937	3,297,269	1,428,469	1,439,887	4,917,406	4,737,156
Changes in net assets	313,617	204,637	(101,921)	(231,299)	211,696	(26,662)
Net assets – beginning of year	3,488,702	3,284,065	10,745,796	10,977,095	14,234,498	14,261,160
Net assets – end of year	\$ 3,802,319	\$ 3,488,702	\$ 10,643,875	\$ 10,745,796	\$ 14,446,194	\$ 14,234,498

Governmental activities. Governmental activities increased the City's net assets by \$313,617, accounting for substantially all of the increase in the City's net assets for fiscal year 2006.

Expenses and Program Revenues - Governmental Activities

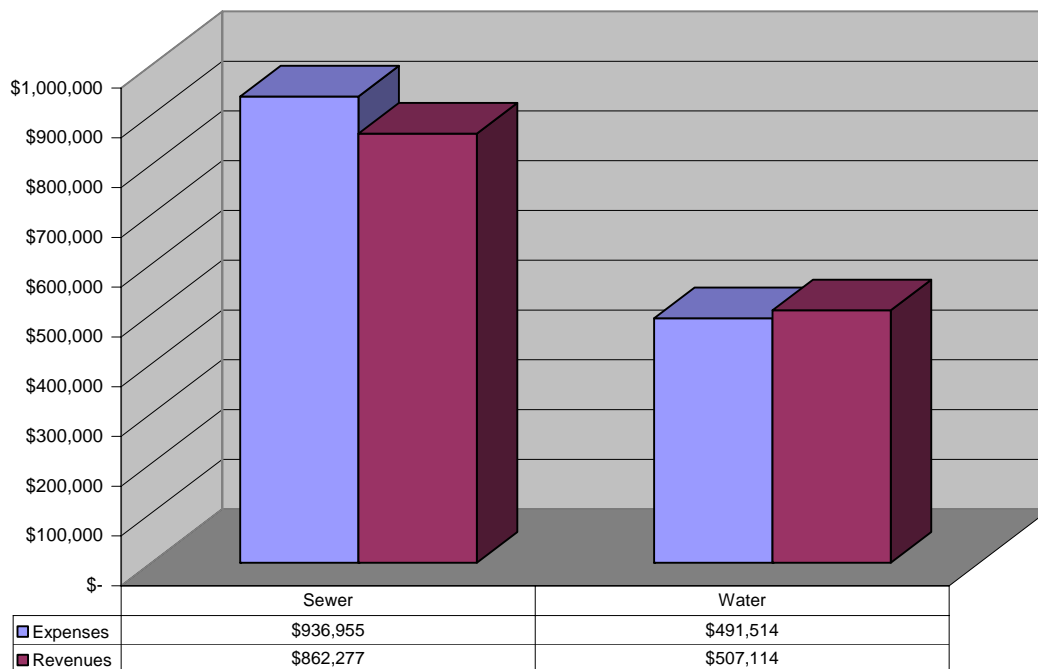


Revenues by Source - Governmental Activities



Business-type activities. Business-type activities decreased the City's net assets by \$101,921.

Expenses and Program Revenues- Business-type Activities



Substantially all revenues for the business-type activities resulted from charges for services.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

The General Fund is the main operating fund of the City. General Fund balance decreased by \$76,573 from \$571,347 to 494,774 during 2006. This decrease is mainly attributable to an allocation from the Fund Balance to cover the City's cost of the Riverfront Improvements Phase II at Major City Park.

Proprietary funds. The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

General Fund Budgetary Highlights

The City's budget was amended due to a federal grant (FEMA), awarded to the City's Department of Public Safety. An amendment was also made to the General Fund portion of the budget to reflect the \$345,000 Energy Upgrade Project both on the revenue and expense side.

Tax revenues and other revenues were at or exceeded expected budgetary levels.

Capital Asset and Debt Administration

Capital assets. The City defines a capital asset as an asset whose cost exceeds \$5,000 and whose useful life is greater than two years. Included in the cost of a capital asset are items such as labor and freight and any other costs associated with bringing the asset into full operation. Assets are depreciated using the straight-line method over the course of their useful lives.

City of Cheboygan
Capital Assets
(net of depreciation, where applicable)
June 30, 2006

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Land	\$ 343,216	\$ 2,251	\$ 345,467
Construction –in-process	595,089	62,804	657,893
Buildings and improvements	4,107,133	698,153	4,805,286
Land improvements	2,264,491	-	2,264,491
Equipment	693,400	323,500	1,016,900
Infrastructure	1,477,629	-	1,477,629
Water system	-	3,414,473	3,414,473
Sewer system	-	5,089,213	5,089,213
Total	<u>\$ 9,480,958</u>	<u>\$ 9,590,394</u>	<u>\$ 19,071,352</u>

Additional information on the City's capital assets can be found in Note 4 pages 29-31 of this report.

Long-term debt. Debt incurred in the course of constructing or acquiring a capital asset is recorded and paid for from a Debt Service Fund or Internal Service Fund. Debt is classified as long-term if the debt matures in a period greater than one year.

Additional information on the City's long-term debt can be found in Note 6 on pages 32-35 of this report.

Economic Factors and Next Year's Budgets and Rates

The City continues to experience increases in property values resulting in increased property tax revenues. However, State of Michigan Shared Revenues are projected to remain at previous year levels, with increases in property taxes negatively affected by millage rollbacks due to the Headlee Amendment. The City of Cheboygan continues to review methods for delivery of services and continues to seek grants and other funding sources.

The 2006/2007 Budget projects continued growth in property values with State Shared Revenues remaining at previous year levels. The budget includes capital expenditures for street resurfacing and for the City of Cheboygan's portion of the funding for replacement of the Lincoln Avenue Bridge in conjunction with Critical Bridge Funds from the Michigan Department of Transportation. The City of Cheboygan will continue to monitor closely its' capital needs, service requirements and upcoming projects as they relate to the budget and projected revenue streams.

Request for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City Treasurer's Office, City of Cheboygan, Michigan, 403 N. Huron St., PO Box 39, Cheboygan, Michigan, 49721.

Basic Financial Statements

City of Cheboygan, Michigan

Statement of Net Assets

June 30, 2006

	Primary Government			Component
	Governmental	Business-type		Units
	Activities	Activities	Totals	
ASSETS:				
Cash & Equivalents - Unrestricted	\$ 801,821	\$ 866,339	\$ 1,668,160	\$ 290,997
Cash & Equivalents - Restricted	149,134	-	149,134	-
Receivables:				
Accounts	17,510	233,450	250,960	-
Taxes	192,231	-	192,231	-
Due From Governmental Units	509,467	-	509,467	-
Prepaid Expenses	72,480	-	72,480	750
Capital Assets Not Depreciated	938,305	65,055	1,003,360	183,865
Capital Assets (Net of Accumulated Depreciation)	8,542,653	9,525,339	18,067,992	-
TOTAL ASSETS	\$ 11,223,601	\$ 10,690,183	\$ 21,913,784	\$ 475,612
LIABILITIES:				
Current Liabilities:				
Accounts Payable	\$ 38,717	\$ 12,594	\$ 51,311	\$ 3,085
Accrued Liabilities	69,327	7,803	77,130	998
Accrued Interest	75,716	-	75,716	-
Due to Other Governmental Units	11,112	10,278	21,390	-
Customer Deposits	-	15,633	15,633	-
Deferred Revenue	-	-	-	-
Installment Loans Payable	91,784	-	91,784	-
Bonds Payable	208,000	-	208,000	-
Non-current Liabilities:				
Installment Loans Payable	397,715	-	397,715	-
Bonds Payable	6,276,000	-	6,276,000	-
Compensated Absences	252,911	-	252,911	-
TOTAL LIABILITIES	7,421,282	46,308	7,467,590	4,083
NET ASSETS:				
Invested in Capital Assets (net of related debt)	2,507,459	9,590,394	12,097,853	183,865
Restricted for Debt Service	106,970	-	106,970	-
Restricted for Capital Projects	204,712	-	204,712	-
Restricted for Perpetual Care	149,134	-	149,134	-
Unrestricted	834,044	1,053,481	1,887,525	287,664
TOTAL NET ASSETS	\$ 3,802,319	\$ 10,643,875	\$ 14,446,194	\$ 471,529

City of Cheboygan, Michigan

Statement of Activities For the Year Ended June 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			Component Unit
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Primary Government Business-Type Activities	Total	
Primary Government:								
Governmental Activities:								
Legislative	\$ 35,098	\$ -	\$ -	\$ -	\$ (35,098)	\$ -	\$ (35,098)	\$ -
General Government	735,122	107,570	6,968	-	(620,584)	-	(620,584)	-
Public Safety	964,777	18,469	44,796	-	(901,512)	-	(901,512)	-
Public Works	1,054,374	39,068	508,107	-	(507,199)	-	(507,199)	-
Recreation & Culture	313,936	7,405	13,000	549,286	255,755	-	255,755	-
Interest Expense - Unallocated	385,630	-	-	-	(385,630)	-	(385,630)	-
Total Governmental Activities	3,488,937	172,512	572,871	549,286	(2,194,268)	-	(2,194,268)	-
Business-type activities:								
Sewer	936,955	829,172	-	-	-	(107,783)	(107,783)	-
Water	491,514	503,341	-	-	-	11,827	11,827	-
Total Business-type Activities	1,428,469	1,332,513	-	-	-	(95,956)	(95,956)	-
Total Primary Government	<u>\$ 4,917,406</u>	<u>\$ 1,505,025</u>	<u>\$ 572,871</u>	<u>\$ 549,286</u>	<u>(2,194,268)</u>	<u>(95,956)</u>	<u>(2,290,224)</u>	<u>-</u>
Component Units:								
Downtown Development Authority	\$ 105,375	\$ -	\$ -	\$ -				(105,375)
Total Component Units	105,375	-	-	-				(105,375)
Total	<u>\$ 5,022,781</u>	<u>\$ 1,505,025</u>	<u>\$ 572,871</u>	<u>\$ 549,286</u>				
General Revenues:								
Property Taxes								
Operating					1,421,187	-	1,421,187	183,594
Debt					377,279	-	377,279	-
State Shared Revenue					630,576	-	630,576	-
Investment Earnings (Loss)					54,368	18,510	72,878	4,398
Local Contributions					-	-	-	11,559
Transfers					24,475	(24,475)	-	-
Total General Revenues and Transfers					2,507,885	(5,965)	2,501,920	199,551
Changes in Net Assets					313,617	(101,921)	211,696	94,176
Net Assets - Beginning					3,488,702	10,745,796	14,234,498	377,353
Net Assets - Ending					<u>\$ 3,802,319</u>	<u>\$ 10,643,875</u>	<u>\$ 14,446,194</u>	<u>\$ 471,529</u>

See accompanying notes to financial statements.

City of Cheboygan, Michigan

Balance Sheet Governmental Funds June 30, 2006

	General	Major Street	Local Street	2000 Sidewalk Special Assessment Bond	2004 General Obligation Bond Construction	Nonmajor Governmental Funds	Total Governmental Funds
ASSETS:							
Cash & Equivalents - Unrestricted	\$ 69,713	\$ 7,854	\$ -	\$ 18,473	\$ 31,593	\$ 671,888	\$ 799,521
Cash & Equivalents - Restricted	-	-	-	-	-	149,134	149,134
Receivables:							
Accounts	17,186	-	-	-	-	324	17,510
Special Assessments	54,924	-	-	105,070	-	32,237	192,231
Due from other funds	20,916	-	-	-	-	-	20,916
Due from Governmental Units	424,564	63,353	21,550	-	-	-	509,467
Prepaid Expense	72,480	-	-	-	-	-	72,480
TOTAL ASSETS	\$ 659,783	\$ 71,207	\$ 21,550	\$ 123,543	\$ 31,593	\$ 853,583	\$ 1,761,259
LIABILITIES:							
Accounts Payable	31,801	64	385	-	425	-	32,675
Accrued Liabilities	67,172	598	573	-	-	-	68,343
Due to other funds	-	-	20,592	-	-	324	20,916
Due to Governmental Units	11,112	-	-	-	-	-	11,112
Deferred Revenue	54,924	-	-	105,070	-	32,237	192,231
TOTAL LIABILITIES	165,009	662	21,550	105,070	425	32,561	325,277
FUND BALANCES:							
Reserved:							
Termination Liability	-	-	-	-	-	106,544	106,544
Retiree BC/BS	-	-	-	-	-	240,539	240,539
Perpetual Care	-	-	-	-	-	149,134	149,134
Debt Service	-	-	-	18,473	-	88,497	106,970
Capital Projects	-	-	-	-	31,168	173,544	204,712
Unreserved:							
Undesignated	494,774	70,545	-	-	-	62,764	628,083
TOTAL FUND BALANCES	494,774	70,545	-	18,473	31,168	821,022	1,435,982
TOTAL LIABILITIES AND FUND BALANCES	\$ 659,783	\$ 71,207	\$ 21,550	\$ 123,543	\$ 31,593	\$ 853,583	
Reconciliation to amounts reported for governmental activities in the statement of net assets:							
Capital assets used by governmental activities							8,837,631
Special assessments receivable							192,231
Compensated absences liability							(252,911)
Long-term notes & leases payable for governmental activities							(6,829,272)
Accrued interest expense							(75,716)
Internal service funds included in governmental activities							494,374
Net assets of governmental activities							\$ 3,802,319

City of Cheboygan, Michigan

Statement of Revenues, Expenditures, and Changes in Fund Balance - Governmental Funds For the Year Ended June 30, 2006

	General	Major Street	Local Street	2000 Sidewalk Special Assessment Bond	2004 General Obligation Bond Construction	Nonmajor Governmental Funds	Totals Governmental Funds
REVENUES:							
Taxes	\$ 1,421,187	\$ -	\$ -	\$ -	\$ -	\$ 377,279	\$ 1,798,466
Special Assessments	14,123	-	-	32,020	-	8,842	54,985
License and Permits	6,605	-	-	-	-	-	6,605
Federal Revenues	42,688	-	-	-	-	-	42,688
State Revenues	1,188,937	377,597	130,510	-	-	-	1,697,044
Charges for Services	50,470	-	26,105	-	-	8,600	85,175
Interest	21,228	2,356	-	461	4,943	25,380	54,368
Other Revenue	56,816	-	-	-	-	13,310	70,126
TOTAL REVENUES	2,802,054	379,953	156,615	32,481	4,943	433,411	3,809,457
EXPENDITURES:							
Legislative	35,098	-	-	-	-	-	35,098
General Government	830,533	-	-	-	-	172,748	1,003,281
Public Safety	948,508	-	-	-	-	-	948,508
Public Works	336,890	252,609	221,755	-	-	-	811,254
Recreation & Cultural	886,746	-	-	-	-	-	886,746
Capital Outlay	-	-	-	-	781,081	273,103	1,054,184
Debt Service	-	-	-	31,150	-	676,900	708,050
TOTAL EXPENDITURES	3,037,775	252,609	221,755	31,150	781,081	1,122,751	5,447,121
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(235,721)	127,344	(65,140)	1,331	(776,138)	(689,340)	(1,637,664)
OTHER FINANCING SOURCES (USES):							
Installment Note Proceeds	345,272	-	-	-	-	-	345,272
Operating Transfers In	-	-	131,014	-	-	265,657	396,671
Operating Transfers Out	(186,124)	(116,867)	(65,955)	-	-	-	(368,946)
Proceeds of Refunding Bonds	-	-	-	-	-	2,705,000	2,705,000
Payment to Refunded Bond Escrow Agent	-	-	-	-	-	(2,605,000)	(2,605,000)
TOTAL OTHER FINANCING SOURCES (USES)	159,148	(116,867)	65,059	-	-	365,657	472,997
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	(76,573)	10,477	(81)	1,331	(776,138)	(323,683)	(1,164,667)
FUND BALANCES, JULY 1	571,347	60,068	81	17,142	807,306	1,144,705	2,600,649
FUND BALANCES, JUNE 30	\$ 494,774	\$ 70,545	\$ -	\$ 18,473	\$ 31,168	\$ 821,022	\$ 1,435,982

See accompanying notes to financial statements.

**Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Year Ended June 30, 2006**

Net Changes in fund balances - total governmental funds \$ (1,164,667)

The change in net assets reported for governmental activities in the statement of activities is different because:

Governmental funds reported capital outlays as expenditures. However, in the statement of activities the cost of those assets is capitalized and the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation expense (\$356,784) exceeded capital outlay (\$2,007,583) in the current period. 1,650,799

Special assessments receivable are long-term in nature and are collectible over several years. However, only the current receipts are reflected as revenues in the funds. (42,022)

Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

Principal payments 311,000
Payment to refunded bond escrow agent 2,605,000

Issuance of bond and installment loan proceeds is an other financing source in the governmental funds, but increases long-term liabilities in the statement of net assets.

Installment Loan Proceeds (345,272)
Bond proceeds - refunding debt (2,705,000)

An internal service fund is used by management to charge the costs of certain activities, such as equipment costs, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities. (3,203)

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the funds:

Compensated absences (15,035)
Accrued Interest 22,017

Changes in net assets of governmental activities \$ 313,617

Statement of Net Assets
Proprietary Funds
June 30, 2006

	Business - type Activities			Governmental Activities
	Enterprise Funds		Total Business-Type	Internal Service Fund
	Sewer	Water		
ASSETS:				
Current Assets				
Cash & Equivalents	\$ 681,548	\$ 184,791	\$ 866,339	\$ 2,300
Receivables:				
Accounts	158,879	74,571	233,450	-
Total Current Assets	840,427	259,362	1,099,789	2,300
Noncurrent Assets				
Capital Assets Not Depreciated	65,055	-	65,055	-
Capital Assets (Net of Accumulated Depreciation)	6,108,745	3,416,594	9,525,339	643,327
Total Noncurrent Assets	6,173,800	3,416,594	9,590,394	643,327
TOTAL ASSETS	<u>\$ 7,014,227</u>	<u>\$ 3,675,956</u>	<u>\$ 10,690,183</u>	<u>\$ 645,627</u>
LIABILITIES:				
Current Liabilities				
Accounts Payable	\$ 8,340	\$ 4,254	\$ 12,594	\$ 6,042
Accrued Liabilities	3,232	4,571	7,803	984
Due to Other Governmental Units	10,278	-	10,278	-
Customer Deposits	-	15,633	15,633	-
Installment Notes Payable	-	-	-	61,178
Total Current Liabilities	21,850	24,458	46,308	68,204
Noncurrent Liabilities				
Installment Notes Payable	-	-	-	83,049
TOTAL LIABILITIES	<u>21,850</u>	<u>24,458</u>	<u>46,308</u>	<u>151,253</u>
NET ASSETS:				
Invested in Capital Assets (net of related debt)	6,173,800	3,416,594	9,590,394	499,100
Unrestricted	818,577	234,904	1,053,481	(4,726)
TOTAL NET ASSETS	<u>\$ 6,992,377</u>	<u>\$ 3,651,498</u>	<u>\$ 10,643,875</u>	<u>\$ 494,374</u>

City of Cheboygan, Michigan

Statement of Revenues, Expenses, and Changes in Net Assets - Proprietary Funds For the Year Ended June 30, 2006

	Business - type Activities			Governmental Activities
	Enterprise			
	Funds		Total Business- Type	Internal Service Fund
	Sewer	Water		
OPERATING REVENUES:				
Charges for Services	\$ 812,139	\$ 465,330	\$ 1,277,469	\$ 437,599
Total Operating Revenues	812,139	465,330	1,277,469	437,599
OPERATING EXPENSES:				
Personal Services	306,359	246,060	552,419	68,604
Contracted Services	76,562	38,250	114,812	2,713
Insurance	28,694	4,228	32,922	37,868
Equipment Rental	37,190	19,921	57,111	244
Supplies	85,452	51,508	136,960	75,933
Utilities	117,066	34,911	151,977	23,249
Repair and Maintenance	-	-	-	61,069
Depreciation	272,334	93,632	365,966	152,940
Miscellaneous	13,298	3,004	16,302	4,335
Total Operating Expenses	936,955	491,514	1,428,469	426,955
OPERATING INCOME (LOSS)	(124,816)	(26,184)	(151,000)	10,644
NON-OPERATING REVENUES (EXPENSES):				
Interest Income	14,737	3,773	18,510	-
Penalties	16,800	8,311	25,111	-
Miscellaneous Revenue	233	29,700	29,933	-
Interest Expense	-	-	-	(10,597)
Total Non-operating Revenues (Expenses)	31,770	41,784	73,554	(10,597)
Income (loss) before transfers	(93,046)	15,600	(77,446)	47
Operating Transfers Out	(15,025)	(9,450)	(24,475)	(3,250)
CHANGES IN NET ASSETS	(108,071)	6,150	(101,921)	(3,203)
NET ASSETS, JULY 1	7,100,448	3,645,348	10,745,796	497,577
NET ASSETS, JUNE 30	<u>\$ 6,992,377</u>	<u>\$ 3,651,498</u>	<u>\$ 10,643,875</u>	<u>\$ 494,374</u>

**Statement of Cash Flows
Proprietary Fund Types
For the Year Ended June 30, 2006**

	Business - Type Activities		Governmental Activities
	Enterprise Funds		
	Sewer	Water	Internal Service Fund
CASH FLOWS FROM OPERATING ACTIVITIES:			
Receipts from Customers	\$ 817,539	\$ 467,437	\$ 1,284,976
Payments to Suppliers	(423,373)	(153,310)	(576,683)
Payments to Employees	(306,549)	(243,122)	(549,671)
Internal Activity - Payments/Receipts with Other Funds	-	-	-
Net Cash Provided (Used) by Operating Activities	87,617	71,005	158,622
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES:			
Penalties	16,800	8,311	25,111
Other Revenue	233	29,700	29,933
Operating transfers out	(15,025)	(9,450)	(24,475)
Net Cash Provided (Used) by Noncapital and Related Financing Activities	2,008	28,561	30,569
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:			
Purchase of capital assets	(148,703)	(30,166)	(178,869)
Interest Payments	-	-	-
Principal Payments	-	-	-
Net Cash Provided (Used) by Capital and Related Financing Activities	(148,703)	(30,166)	(178,869)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Interest income	14,737	3,773	18,510
Net Cash Provided (Used) by Investing Activities	14,737	3,773	18,510
Net Increase (Decrease) in Cash and Cash Equivalents	(44,341)	73,173	28,832
Balances - Beginning of the Year	725,889	111,618	837,507
Balances - End of the Year	\$ 681,548	\$ 184,791	\$ 866,339

**Reconciliation of Operating Income (Loss) to
Net Cash Provided (Used) by Operating Activities:**

Operating Income (Loss)	\$ (124,816)	\$ (26,184)	\$ (151,000)	\$ 10,644
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:				
Depreciation Expense	272,334	93,632	365,966	152,940
Loss on Capital Asset Disposal	143	-	143	-
Change in Assets and Liabilities:				
(Increase) Decrease in Assets:				
Accounts Receivable	5,400	2,107	7,507	-
Increase (Decrease) in Liabilities:				
Accounts Payable	3,252	(2,788)	464	(215)
Accrued Expenses	(190)	2,938	2,748	293
Customer Deposits	-	1,300	1,300	-
Due to Other Governmental Units	(68,506)	-	(68,506)	-
Net Cash Provided by Operating Activities	\$ 87,617	\$ 71,005	\$ 158,622	\$ 163,662

Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2006

	<u>Agency Funds</u>
ASSETS:	
Cash & Equivalents - Unrestricted	\$ 16,441
Note Receivable	<u>2,648,959</u>
 TOTAL ASSETS	 <u><u>\$ 2,665,400</u></u>
 LIABILITIES:	
Due to Other Governmental Units	\$ 16,441
Due to State	<u>2,648,959</u>
 TOTAL LIABILITIES	 <u><u>\$ 2,665,400</u></u>

Notes to Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**A. Reporting Entity**

As required by accounting principles generally accepted in the United States of America, the financial statements of the reporting entity include those of *the City of Cheboygan* (the “City”) and its component unit. The component unit discussed below is included in the City’s reporting entity because of the significance of its operational or financial relationship with the City.

Discretely Presented Component Unit. The Downtown Development Authority (the “DDA”) is reported in a separate column to emphasize that it is legally separate from the City. The members of the governing board of the DDA are appointed by the City Council. The budgets and expenditures of the DDA must be approved by the City Council. The City also has the ability to significantly influence operations of the DDA. Separate financial statements of the DDA have not been prepared.

Blended Component Unit. The Cheboygan Brownsfield Redevelopment Authority is an entity legally separate from the City. The Authority is governed by a board appointed by the City Council and is reported as if it were part of the City’s operations because it is financially accountable to the City. There has been no activity during fiscal year 2006.

B. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government and its component unit. For the most part, the effect of interfund activity has been removed from these statements. *Governmental Activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. Likewise, the *primary government* is reported separately from the legally separate *component unit* for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements.

Fund Financial Statements. The fund financial statements provide information about the City’s funds, including its fiduciary funds. Separate statements for each fund category – *governmental*, *proprietary*, and *fiduciary* – are presented. The emphasis of fund financial statements is on major governmental and proprietary funds, each displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The *Major Street Fund* accounts for the use of motor fuel taxes which are restricted by State statutes for major street and highway purposes.

The *Local Street Fund* accounts for the use of motor fuel taxes which are restricted by State statute for local street purposes.

The *2000 Streetscape Special Assessment Bond Fund* accounts for the 2000 special assessment revenues received to repay, and the payments on the bonds issued for street improvements.

The *2004 General Obligation Bond Construction Fund* accounts for the bond proceeds received and the construction costs of the City's new public safety building.

The City reports the following major proprietary funds:

The *Sewer Fund* accounts for the activities of the City's sewage disposal and sewer treatment system.

The *Water Fund* accounts for the activities of the City's water distribution and water treatment system.

Additionally, the City reports the following fund types:

Special Revenue Funds. These funds account for revenue sources that are legally restricted to expenditures for specific purposes not including major capital projects.

Debt Service Funds. These funds account for the resources accumulated and payments made for principal and interest on long-term debt of governmental funds.

Capital Project Funds. These funds account for the acquisition of capital assets or construction of major capital projects not being financed by proprietary funds.

Internal Service Fund. This fund accounts for operations that provide machinery and equipment to other departments of the City on a cost-reimbursement basis.

Agency Funds. These funds account for assets held for others in an agency capacity.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

Government-wide, Proprietary and Fiduciary Fund Financial Statements. The government-wide, proprietary, and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, except for agency funds which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Fund Financial Statements. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The City considers all revenues reported in the governmental funds to be available if they are collected within 60 days after year-end. Property taxes, state revenue, and interest are considered to be susceptible to accrual.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent they have matured. Capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of long-term debt and acquisitions under capital leases, if any, are reported as other financing sources.

The government-wide financial statements and proprietary funds of the City follow private-sector standards of accounting and financial reporting issued prior to December 1, 1989, unless those standards conflict with guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and proprietary type funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the City's water and sewer function and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided and 2) operating grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise and internal service funds are charges to customers for sales and services. The City also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, Liabilities, and Equity***Deposits and Investments***

The City maintains an investment pool for certain City funds. Each fund's portion of the investment pool is displayed on the statement of net assets/balance sheet as "Cash and cash equivalents". The debt service and trust and agency funds cash resources are invested separately as required by law.

The City's cash and cash equivalents includes cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

State statutes authorize the City's investment policy allows the City to deposit in the accounts of federally insured banks, credit unions and savings and loan associations and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments.

The City's investments during the year consisted of certificate of deposits and prime vest sweep account, which is invested in money market funds.

Receivables and Payables

All receivables are reported at their gross value.

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reports as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prepaid Items

Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in both the government-wide and fund financial statements.

Property Taxes

The City's property taxes are levied each July 1 on the taxable valuation of property located in the City as of the preceding December 31, the lien date. Property taxes are payable without penalty and interest through July 31; as of March 1 of the succeeding year, unpaid real property taxes are sold to and collected by Cheboygan County.

Property taxes for the DDA are derived by capturing the taxes assessed on the increase in taxable value of the property located within the DDA district.

Property taxes are recognized in the fiscal year in which they are levied.

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, sidewalks, and similar items), reported in the applicable governmental or business-type activities columns in the government-wide financial statements. The City defines capital assets as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

At adoption of GABS 34, the City elected to retrospectively report infrastructure back 27 years.

Capital assets of the primary government are depreciated using the straight-line method over the following estimated useful lives:

Buildings	15-40 years
Land improvements	10-40 years
Equipment	3-30 years
Public domain infrastructure	30 years
Sewer and water infrastructure	7-75 years

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)***Compensated Absences***

It is the City's policy to permit employees to accumulate earned but unused sick and vacation time benefits, subject to certain limitations. All sick and vacation time pay is accrued when incurred in the government-wide statements. A liability for these amounts is reported in governmental funds only if they have matured, for example as a result of employee resignations or retirements.

Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets.

In the fund financial statements, governmental funds report the face amount of debt issued as other financing sources.

Fund Balance

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

NOTE 2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY***Budgetary Information***

Budgetary Information – Annual budgets are adopted on a basis consistent with U.S. generally accepted accounting principles.

Budgets and Budgetary Control – The City follows these procedures in establishing the budgetary data reflected in the financial statements:

- a. Each June, after receiving input from the individual departments, the City Manager prepares a proposed operating budget for the fiscal period commencing July 1 and lapses on June 30. The operating budget includes proposed expenditures and the means of financing them.
- b. Public hearings are conducted to obtain taxpayer comments.
- c. Prior to July 1, the budget is legally enacted through a resolution passed by the City Council.

NOTE 2. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY (Continued)

- d. Budgetary control is exercised at the departmental level of the General Fund. Any revisions that alter the total expenditures of any department or fund (i.e., budget amendments) require approval by the City Council. Such amendments are made in accordance with the procedures prescribed under Public Act 621 of 1978.
- e. The budget and approved appropriations lapse at the end of the fiscal year.
- f. The City does not record encumbrances in the accounting records during the year as normal practice and, therefore, no outstanding encumbrances exist at year end.

Budgeted amounts are as originally adopted or amended by the City Council during the year. Individual amendments were not material in relation to the original appropriations which were amended. The modified accrual basis of accounting is used for budgetary purposes.

The General Fund revenue budget was adopted on the basis of activities or programs financed by the General Fund.

Michigan Public Act 621 of 1978 (the Budgeting Act) requires that budgets be adopted for Governmental Funds. U.S. generally accepted accounting principles require that the financial statements present budgetary comparisons for the Governmental Fund Types for which budgets were legally adopted. The original budget adopted for the General fund was modified throughout the year through various budget amendments.

The budget document presents information by fund, function, department, and line items. The legal level of budgetary control adopted by the governing body is the department level.

NOTE 3. DEPOSITS AND INVESTMENTS

At year end, the City's deposits and investments were reported in the basic financial statements in the following categories:

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total Primary Government</u>	<u>Fiduciary Funds</u>	<u>Component Units</u>
Cash and Cash Equivalents - Unrestricted	\$ 801,821	\$ 866,339	\$ 1,668,160	\$ 16,441	\$ 290,997
Cash and Cash Equivalents - Restricted	<u>149,134</u>	<u>-</u>	<u>149,134</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 950,955</u>	<u>\$ 866,339</u>	<u>\$ 1,817,294</u>	<u>\$ 16,441</u>	<u>\$ 290,997</u>

NOTE 3. DEPOSITS AND INVESTMENTS (Continued)

The breakdown between deposits and investments is as follows:

	Primary Government	Fiduciary Funds	Component Units
Bank Deposits (checking and savings accounts, certificates of deposit)	\$ 1,816,294	\$ 16,441	\$ 290,997
Petty Cash and Cash on Hand	<u>1,000</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 1,817,294</u>	<u>\$ 16,441</u>	<u>\$ 290,997</u>

Interest rate risk. The City does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. State law limits investments in commercial paper, corporate bonds, and mutual bond funds to the top two ratings issued by nationally recognized statistical rating organizations. The City has no investment policy that would further limit its investment choices.

Custodial deposit credit risk. Custodial deposit credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned. State law does not require and the City does not have a policy for deposit custodial credit risk. As of year end, \$1,773,893 of the City's bank balance of \$2,166,787 was exposed to credit risk because it was uninsured and uncollateralized.

Statutory Authority:

Michigan Law (Public Act 20 of 1943 as amended) authorizes the City to deposit and invest in one or more of the following:

- a. Bond, securities, and other obligations of the United States or an agency or instrumentality of the United States.
- b. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a financial institution that is eligible to be a depository of funds belonging to the State under a law or rule of this State or the United States.
- c. Commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and matures not more than 270 days after the date of purchase.
- d. Repurchase agreements consisting of instruments listed in a.
- e. Banker's acceptance of United States banks.

NOTE 3. DEPOSITS AND INVESTMENTS (Continued)

- f. Obligations of this State or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than one standard rating service.
- g. Mutual funds registered under the investment company act of 1940, Title I of Chapter 686, 54 Stat. 789, 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64, with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation.
- h. Obligation described in a. through g. if purchased through an interlocal agreement under the urban cooperations act of 1967, 1967 (Ex Sess) PA 7, MCL 124.501 to 124.512.
- i. Investment pools organized under the surplus funds investment pool act, 1982 PA 367, 129.111 to 129.118.
- j. The investment pools organized under the local government investment pool act, 1985 PA 121, MCL 129.141 to 129.150.

The City's deposits and investment policy are in accordance with statutory authority.

These deposits are in various financial institutions in varying amounts. All accounts are in the name of the City and specific funds. They are recorded in City records at cost. Interest is recorded when the deposits mature or is credited to the applicable account.

NOTE 4. CAPITAL ASSETS

Capital asset activity for the primary government for the current year was as follows:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Transfers</u>	<u>Decreases</u>	<u>Ending Balances</u>
Governmental Activities:					
<i>Capital assets not being depreciated:</i>					
Land	\$ 205,721	\$ -	\$ 137,495	\$ -	\$ 343,216
Construction-in-process	<u>555,340</u>	<u>595,089</u>	<u>(555,340)</u>	<u>-</u>	<u>595,089</u>
Subtotal	<u>761,061</u>	<u>595,089</u>	<u>(417,845)</u>	<u>-</u>	<u>938,305</u>
<i>Capital assets being depreciated:</i>					
Buildings	4,281,366	752,650	417,845	-	5,451,861
Land improvements	3,181,845	645,744	-	-	3,827,589
Equipment	3,084,512	65,875	-	113,243	3,037,144
Infrastructure	<u>2,936,119</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,936,119</u>
Subtotal	<u>13,483,842</u>	<u>1,464,269</u>	<u>417,845</u>	<u>113,243</u>	<u>15,252,713</u>

NOTE 4. CAPITAL ASSETS (Continued)

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Transfers</u>	<u>Decreases</u>	<u>Ending Balances</u>
Governmental Activities:					
<i>Less accumulated depreciation for:</i>					
Buildings and improvements	(1,233,254)	(111,474)	-	-	(1,344,728)
Land improvements	(1,426,447)	(136,651)	-	-	(1,563,098)
Equipment	(2,293,257)	(163,730)	-	113,243	(2,343,744)
Infrastructure	(1,360,621)	(97,869)	-	-	(1,458,490)
Subtotal	(6,313,579)	(509,724)	-	113,243	(6,710,060)
Net capital assets being depreciated	7,170,263	954,545	417,845	-	8,542,653
Governmental Activities Capital Assets – Net of Depreciation	<u>\$ 7,931,324</u>	<u>\$ 1,549,634</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,480,958</u>
Business-type activities:					
<i>Capital assets not being depreciated:</i>					
Land	\$ 2,251	\$ -	\$ -	\$ -	\$ 2,251
Construction-in-process	5,040	57,764	-	-	62,804
Subtotal	7,291	57,764	-	-	65,055
<i>Capital assets being depreciated:</i>					
Buildings and improvements	2,321,996	-	-	-	2,321,996
Sewer system	7,222,200	-	-	-	7,222,200
Water system	5,012,371	30,166	-	-	5,042,537
Equipment	2,729,755	90,939	-	8,595	2,812,099
Subtotal	17,286,322	121,105	-	8,595	17,398,832
<i>Less accumulated depreciation for:</i>					
Buildings and improvements	(1,565,791)	(58,052)	-	-	(1,623,843)
Sewer system	(2,020,554)	(112,433)	-	-	(2,132,987)
Water system	(1,534,434)	(93,630)	-	-	(1,628,064)
Equipment	(2,395,200)	(101,851)	-	8,452	(2,488,599)
Subtotal	(7,515,979)	(365,966)	-	8,452	(7,873,493)
Net capital assets being depreciated	9,770,343	(244,861)	-	(143)	9,525,339
Business-type Activities Capital Assets - Net of Depreciation	<u>\$ 9,777,634</u>	<u>\$ (187,097)</u>	<u>\$ -</u>	<u>\$ (143)</u>	<u>\$ 9,590,394</u>
Component Unit:					
<i>Capital assets not being depreciated:</i>					
Land	\$ 150,000	\$ -	\$ -	\$ -	\$ 150,000
Construction-in-process	17,165	16,700	-	-	33,865
Net Capital Assets Being Depreciated	<u>\$ 167,165</u>	<u>\$ 16,700</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 183,865</u>

NOTE 4. CAPITAL ASSETS (Continued)

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities	
General government	\$ 72,555
Public Safety	9,075
Public Works	202,374
Culture and Recreation	72,780
Capital assets held by the government's internal service funds are charged to the various functions based on their usage of the assets	<u>152,940</u>
Total Depreciation Expense - Governmental Activities	<u>\$ 509,724</u>
Business-type Activities	
Sewer	\$ 272,334
Water	<u>93,632</u>
Total Depreciation Expense - Business-type Activities	<u>\$ 365,966</u>

NOTE 5. INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS

The City reports interfund balances between its funds. Some of the balances are considered immaterial and are aggregated into a single column or row. The total of all balances agrees with the sum of interfund balances presented in the statements of net assets/balance sheet for governmental funds. Interfund transactions resulting in interfund Receivables and Payable are as follows:

DUE FROM OTHER FUNDS	DUE TO OTHER FUNDS	
		General Fund
	Local Streets	\$ 20,592
	Nonmajor Funds	<u>324</u>
	Total	<u>\$ 20,916</u>

NOTE 5. INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS (Continued)**Interfund Transfers:**

		TRANSFERS IN		
TRANSFERS OUT		Local Streets Fund	Nonmajor Governmental Funds	Totals
	General Fund	\$ 14,147	\$ 171,977	\$ 186,124
	Major Street Fund	116,867	-	116,867
	Local Streets	-	65,955	65,955
	Sewer Fund	-	15,025	15,025
	Water Fund	-	9,450	9,450
	Internal Service Fund	-	3,250	3,250
	Total	\$ 131,014	\$ 265,657	\$ 396,671

Transfers are used to (1) move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, (2) moves receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

NOTE 6. LONG-TERM DEBT

The government issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the government. City contractual agreements and installment purchase agreements are also general obligations of the government.

Bond and contractual obligation activity can be summarized as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Governmental Activities					
Bonds Payable					
1997 Water and Sanitary Sewer System Improvement General Obligation Bonds, maturing serially to 2022 in annual amounts ranging from \$10,000 to \$285,000 and bearing interest ranging from 5.0% to 7.5%.	\$ 2,740,000	\$ -	\$ 2,740,000	\$ -	\$ -

NOTE 6 LONG-TERM DEBT (Continued)

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
1997 Rural Economic Development Bonds, maturing serially to 2037 in annual amounts ranging from \$19,000 to \$108,000 and bearing interest at 4.5%	\$ 1,825,000	\$ -	\$ 26,000	\$ 1,799,000	\$ 28,000
2004 General Obligation Bonds. Bonds maturing serially to 2023 in annual payments ranging from \$25,000 to \$105,000 and bearing interest of 3.25% to 5.15%.	1,325,000	-	35,000	1,290,000	35,000
2002 Major and Local Street General Obligation Bonds, maturing serially to 2012 in annual amounts ranging from \$25,000 to \$45,000 and bearing interest at 3.95%.	265,000	-	30,000	235,000	35,000
1997 Michigan Transportation Fund Bonds, maturing serially to 2012 in annual amounts ranging from \$15,000 to \$30,000 and bearing interest ranging from 4% to 5.8%.	180,000	-	20,000	160,000	25,000
2000 Special Assessment Streetscape Bonds, maturing serially to 2010 in annual amounts ranging from \$10,000 to \$30,000 and bearing interest ranging from 5.0% to 7.0%.	130,000	-	25,000	105,000	25,000
1998 Local Street Paving Bonds, maturing serially to 2009 in annual amounts ranging from \$20,000 to \$30,000 and bearing interest ranging from 3.9% to 4.7%.	110,000	-	25,000	85,000	25,000
2001 Sidewalk Improvement General Obligation Bonds, maturing serially to 2012 in annual amounts ranging from \$4,000 to \$10,000 and bearing interest at 4.15%.	70,000	-	10,000	60,000	10,000
2001 Sidewalk Improvement Special Assessment Limited Tax General Obligation Bonds, maturing serially to 2012 in annual amounts ranging from \$3,000 to \$10,000 and bearing interest at 4.15%.	50,000	-	5,000	45,000	5,000
2006 General Obligation Unlimited Tax Refunding Bonds, maturing serially to 2022 In annual amounts ranging from \$20,000 to \$265,000 and bearing interest from 3.6% to 4.0%.	-	2,705,000	-	2,705,000	20,000
Total Bonds Payable	<u>\$ 6,695,000</u>	<u>\$ 2,705,000</u>	<u>\$ 2,916,000</u>	<u>\$ 6,484,000</u>	<u>\$ 208,000</u>

NOTE 6 LONG-TERM DEBT (Continued)

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Notes Payable and Other					
2000 Act 99 Equipment, note payable with annual payments of \$25,628 including interest at 5.48%.	\$ 89,593	\$ -	\$ 20,597	\$ 68,996	\$ 21,754
2003 Act 99 Equipment, note payable with annual payments of \$22,260 including interest at 2.691%.	43,440	-	21,142	22,298	22,298
2003 Act 99 Equipment, note payable with annual payments of \$22,313 including interest at 6.75%	20,902	-	20,902	-	-
2003 Act 99 Equipment, note payable with annual payments of \$16,897 including interest at 5.95%.	15,948	-	15,948	-	-
2004 GMC Top Kick Act 99, note payable with monthly payments of \$18,715 including interest at 3.042%.	69,562	-	16,629	52,933	17,126
2001 Act 99 Equipment, note payable with monthly payments of \$274 including interest at 9.98%.	523	-	523	-	-
2006 Act 99 Energy Equipment, note payable with semi-annual payments ranging from \$16,035 to \$26,737 including interest at 3.98%.	-	345,272	-	345,272	30,606
Accumulated compensated absences	<u>237,876</u>	<u>15,035</u>	<u>-</u>	<u>252,911</u>	<u>-</u>
Total Notes Payable and Other	<u>477,844</u>	<u>360,307</u>	<u>95,741</u>	<u>742,410</u>	<u>91,784</u>
Total Long-Term Debt	<u>\$ 7,172,844</u>	<u>\$ 3,065,307</u>	<u>\$ 3,011,741</u>	<u>\$ 7,226,410</u>	<u>\$ 299,784</u>

Accumulated compensated absences are generally liquidated by the General Fund.

NOTE 6 LONG-TERM DEBT (Continued)

Annual debt service requirements to maturity for the above obligations are as follows:

Year End June 30	Governmental Activities	
	Principal	Interest
2007	\$ 299,784	\$ 306,219
2008	364,356	275,448
2009	390,195	260,179
2010	343,099	244,194
2011	342,788	230,379
2012-2016	1,675,277	958,654
2017-2021	1,765,000	607,878
2022-2026	864,000	279,798
2027-2031	366,000	169,290
2032-2036	455,000	77,288
2037-2041	108,000	2,430
Total	\$ 6,973,499	\$ 3,411,757

Advance Refunding

During 2006, the City advance refunded 1997 water and sanitary sewer system improvement bonds with a separate general obligation refunding. The government issued \$2,705,000 of general obligation refunding bonds to provide resources to purchase state and local government securities that were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of the refunded debt. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the statement of net assets. This advance refunding was undertaken to reduce total debt service payments over the next sixteen years by \$252,523 and to obtain an economic gain (difference between the present value of the debt service payments of the refunded and refunding bonds) of \$156,788.

NOTE 7. RISK MANAGEMENT

The City is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters for which it obtains coverage from commercial insurance companies. The City has had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years.

NOTE 8. EMPLOYEE RETIREMENT AND BENEFIT SYSTEMS

Plan Description

The City's defined benefit pension plan provides retirement, death and disability benefits to plan members and beneficiaries. The City participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer plan administered by the MERS Retirement Board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917-9755.

NOTE 8. EMPLOYEE RETIREMENT AND BENEFIT SYSTEMS (Continued)**Funding Policy**

The City is required to contribute at an actuarially determined rate; the current rate ranges from 9.59% to 14.59% of annual covered payroll. City employees are required to contribute 4.7% of all covered wages. The contribution requirements of the City are established and may be amended by the Retirement Board of MERS. The contribution requirements of plan members are established and may be amended by the City, depending on the MERS contribution program adopted by the City.

Annual Pension Cost

For the year ended June 30, 2006, the City's annual pension cost of \$139,344 for MERS was equal to the City's required and actual contributions. The required contribution was determined using the entry age actuarial cost method. The actuarial assumptions included (a) a rate of return on the investment of present and future assets of 8%, (b) additional projected salary increases up to 4.2% per year, depending on age, attributable to seniority/merit, and (c) an inflationary rate of 4.5%. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return, and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2005, the date of the last actuarial valuation, was 30 years.

Three-year Trend Information			
Year Ended Dec 31	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2004	\$ 119,970	100%	0
2005	143,635	100%	0
2006	139,344	100%	0

Three year trend information as of June 30, follows:

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Actuarial Value of Assets	\$ 5,608,877	\$ 5,847,124	\$ 6,011,983
Actuarial Accrued Liability	6,665,885	7,473,999	7,906,518
Unfunded AAL	1,057,008	1,626,875	1,894,535
Funded Ratio	84%	78%	76%
Covered Payroll	1,291,949	1,270,996	1,314,235
UAAL as a Percentage of Covered Payroll	82%	128%	144%

NOTE 8. EMPLOYEE RETIREMENT AND BENEFIT SYSTEMS (Continued)

Accumulated Sick and Vacation Pay

Employees of the City earn sick and vacation time at varying rates based on the following:

Under the terms of the Police and AFCSME union contract (DPW, sewer and clerical employees), sick leave is accumulated at the rate of one day for each month of service, with a maximum accumulation of 60 days. Employees who have accumulated more than 60 days will not be allowed additional accumulation. Upon retirement or death, employees will be paid out 100% of days accumulated up to a maximum of 60 days.

As a result of separation for any other reason, the employees will lose all accumulated sick leave.

City management personnel earn sick leave at a rate of eight hours per month of service. All unused sick time is paid out, generally in November of each year, at 50% of the employee's current rate of pay.

Vacation leave is earned based on the following schedule for all employees:

<u>Years of Service</u>	<u>Vacation Days</u>
1	2 weeks
5	3 weeks
10	4 weeks
20	4 weeks plus ½ day for each year beyond 20 years

No more than 50% of an employee's annual vacation leave may be carried over to the next employment year and no accumulation is allowed beyond six weeks of annual leave.

The accumulated sick and vacation pay liability is \$252,911 at June 30, 2006. The City has established a Termination Liability Special Revenue Fund to accumulate amounts necessary to cover this liability as it becomes due. The balance in the Termination Liability Fund at June 30, 2006 is \$106,544.

NOTE 9. POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in note 8, the City provides post-employment health care benefits, in accordance with City policy, to all employees hired prior to April 27, 1999 who retire from the City on or after attaining age 55 with 25 years of service or retirement at age 62. Currently eight employees meet those eligibility requirements. The City will pay a pre-established monthly amount towards the employees health insurance cost through the age of 65, with a 3% increase each year. Expenditures for post employment healthcare benefits are recognized as incurred. During the fiscal year ended June 30, 2006, expenditures of \$103,875 were recognized for post employment healthcare.

NOTE 10. CONDUIT DEBT

On August 6, 1994, the City borrowed \$3,000,000 from the United States Department of Housing and Urban Development (HUD) under the provisions of Section 108 of the Housing and Community Development Act of 1974, as amended, for the Great Lakes Tissue Company Project. This loan was used to assist the Great Lakes Tissue Company in connection with the purchase of the former Proctor & Gamble Company facility.

On September 17, 1994 Great Lakes Tissue Company signed a note receivable with the City of Cheboygan for \$3,000,000 representing amounts owed to the City from Great Lakes Tissue Company for the economic development project designed to establish additional employment in the City of Cheboygan. The outstanding note receivable balance as of June 30, 2006 is \$2,648,959. Because this receivable is not available for use by the City, a liability has been recorded, in the amount of \$2,648,959, to offset the receivable balance.

During the year ended June 30, 2005, the State of Michigan loaned funds to Great Lakes Tissue Company, which were used to repay the loan to HUD. The note payable from the State of Michigan to Great Lakes Tissue Company is due in monthly installments ranging from \$17,000 to \$25,000, beginning January 1, 2005 with interest charged at 7%. The final payment is due January 1, 2025. The note payable is secured by a second priority security interest covering all machinery and equipment and second priority mortgage covering all real property. The note payable is to be repaid with principal and interest payments received from Great Lakes Tissue Company. Future annual principal and interest payments are scheduled as follows: \$204,000 in 2007 through 2009, \$252,000 in 2010 and \$300,000 through 2022 and \$185,000 in 2023. The outstanding balance, to the State of Michigan, at June 30, 2006 is \$2,648,959.

Neither the full faith and credit nor the taxing power of the City is pledged for the payment of the notes. Since the debt payments are being made by Great Lakes Tissue Company, the debt has not been recorded by the City.

NOTE 11. SUBSEQUENT EVENT

In July of 2006 the City issued \$340,000 of Michigan Transportation Fund Bonds for resurfacing City streets.

NOTE 12. RELATED PARTY

The City conducts business with a local engineering firm. United Design performs engineering services for the City, which at June 30, 2006 amounted to \$72,610. The City Mayor is one of the owners of United Design.

Required Supplemental Information

City of Cheboygan, Michigan

Required Supplemental Information Budgetary Comparison Schedule General Fund For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES:				
Taxes	\$ 1,424,200	\$ 1,430,350	\$ 1,421,187	\$ (9,163)
Special Assessments	11,000	10,000	14,123	4,123
Licenses & Permits	-	-	6,605	6,605
Federal Sources	-	3,750	42,688	38,938
State Sources	1,185,000	1,225,100	1,188,937	(36,163)
Charges for Services	58,000	59,200	50,470	(8,730)
Interest	5,000	11,000	21,228	10,228
Other Revenue	30,000	69,428	56,816	(12,612)
TOTAL REVENUES	2,713,200	2,808,828	2,802,054	(6,774)
EXPENDITURES:				
Legislative:				
City Council	45,200	38,700	35,098	3,602
General Government:				
City Manager	95,150	103,250	110,616	(7,366)
Clerk - Treasurer	161,100	179,050	169,086	9,964
Clerk - Elections	5,250	1,360	2,610	(1,250)
Assessor	76,350	60,000	60,561	(561)
Board of Review	4,500	3,550	3,430	120
City Hall and Grounds	111,650	503,300	484,230	19,070
Total General Government	454,000	850,510	830,533	19,977
Public Safety:				
Police Department	839,000	786,500	779,037	7,463
Fire Department	99,360	144,450	151,924	(7,474)
Parking	16,350	19,250	17,547	1,703
Total Public Safety	954,710	950,200	948,508	1,692
Public Works:				
Public Works	191,400	279,600	276,142	3,458
Street Lighting	58,000	60,000	60,748	(748)
Total Public Works	249,400	339,600	336,890	2,710
Recreation and Culture				
Recreation Department	877,600	853,650	851,243	2,407
Opera House	21,000	21,000	21,000	-
Soccer Field	-	-	143	(143)
Humane Society	7,000	7,000	7,000	-
Promotion	7,000	7,000	7,360	(360)
Beautification	1,000	-	-	-
Total Recreation & Culture	913,600	888,650	886,746	1,904
TOTAL EXPENDITURES	2,616,910	3,067,660	3,037,775	29,885
EXCESS OF REVENUES OVER EXPENDITURES	96,290	(258,832)	(235,721)	23,111
OTHER FINANCING SOURCES (USES):				
Installment Note Proceeds	-	345,272	345,272	-
Operating Transfers In	153,925	95,000	-	(95,000)
Operating Transfers Out	(249,980)	(181,440)	(186,124)	(4,684)
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	\$ 235	\$ -	(76,573)	\$ (76,573)
FUND BALANCE, JULY 1			571,347	
FUND BALANCE, JUNE 30			\$ 494,774	

City of Cheboygan, Michigan

Required Supplemental Information Budgetary Comparison Schedule Major Street Fund For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES:				
State Sources	\$ 361,000	\$ 371,500	\$ 377,597	\$ 6,097
Interest	-	-	2,356	2,356
 TOTAL REVENUES	 361,000	 371,500	 379,953	 8,453
EXPENDITURES:				
Public Works	262,940	251,815	252,609	(794)
 EXCESS OF REVENUES OVER EXPENDITURES	 98,060	 119,685	 127,344	 7,659
OTHER FINANCING SOURCES (USES):				
Operating Transfers Out	(98,060)	(119,685)	(116,867)	2,818
 EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	 \$ -	 \$ -	 10,477	 \$ 10,477
 FUND BALANCE, JULY 1			 60,068	
 FUND BALANCE, JUNE 30			 \$ 70,545	

City of Cheboygan, Michigan

Required Supplemental Information Budgetary Comparison Schedule Local Street Fund For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES:				
State Sources	\$ 130,000	\$ 128,000	\$ 130,510	\$ 2,510
Charges for Services	26,000	27,500	26,105	(1,395)
TOTAL REVENUES	156,000	155,500	156,615	1,115
EXPENDITURES:				
Public Works	247,950	221,850	221,755	95
EXCESS OF REVENUES OVER EXPENDITURES	(91,950)	(66,350)	(65,140)	1,210
OTHER FINANCING SOURCES (USES):				
Operating Transfers In	153,540	125,750	131,014	5,264
Operating Transfers Out	(61,600)	(59,400)	(65,955)	(6,555)
TOTAL OTHER FINANCING SOURCES (USES)	91,940	66,350	65,059	(1,291)
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	\$ (10)	\$ -	(81)	\$ (81)
FUND BALANCE, JULY 1			81	
FUND BALANCE, JUNE 30			\$ -	

Other Supplemental Information

City of Cheboygan, Michigan

Combining Balance Sheet Nonmajor Governmental Funds June 30, 2006

	Special Revenue Funds				Debt Service Funds				
		Retiree BC/BS Investment Fund	PA 222 Liability	Termination Liability	1997 Water/Sewer Improvement Bonds	1997 Rural Economic Development Loan	1998 Local Street Paving Bond	1996 Street Paving Bonds	2001 Sidewalk Special Assessment Bond
ASSETS:									
Cash & Equivalents - Unrestricted	\$ -	\$ 240,539	\$ 62,764	\$ 106,544	\$ 3,170	\$ 34,007	\$ -	\$ -	\$ 24,918
Cash & Equivalents - Restricted	-	-	-	-	-	-	-	-	-
Receivables:									
Accounts	324	-	-	-	-	-	-	-	-
Special Assessments	-	-	-	-	-	-	-	-	32,237
TOTAL ASSETS	\$ 324	\$ 240,539	\$ 62,764	\$ 106,544	\$ 3,170	\$ 34,007	\$ -	\$ -	\$ 57,155
LIABILITIES:									
Due To Other Funds	\$ 324	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Deferred Revenue	-	-	-	-	-	-	-	-	32,237
TOTAL LIABILITIES	324	-	-	-	-	-	-	-	32,237
FUND BALANCES:									
Reserved:									
Retiree BC/BS	-	240,539	-	-	-	-	-	-	-
Termination Liability	-	-	-	106,544	-	-	-	-	-
Perpetual Care	-	-	-	-	-	-	-	-	-
Debt Service	-	-	-	-	3,170	34,007	-	-	24,918
Capital Projects	-	-	-	-	-	-	-	-	-
Unreserved:									
Undesignated	-	-	62,764	-	-	-	-	-	-
TOTAL FUND BALANCES	-	240,539	62,764	106,544	3,170	34,007	-	-	24,918
TOTAL LIABILITIES AND FUND BALANCES	\$ 324	\$ 240,539	\$ 62,764	\$ 106,544	\$ 3,170	\$ 34,007	\$ -	\$ -	\$ 57,155

City of Cheboygan, Michigan

Combining Balance Sheet Nonmajor Governmental Funds June 30, 2006

	Debt Service Funds			Capital Project Funds			Permanent Fund	
	2001 Sidewalk General Obligation Bond	2002 Transportation Bond	2004 General Obligation Bond	2001 Sidewalk Improvement	2002 Street Construction	Lincoln Bridge Replacement	Cemetery Perpetual Care	Totals
ASSETS:								
Cash & Equivalents - Unrestricted	\$ -	\$ -	\$ 26,402	\$ -	\$ -	\$ 173,544	\$ -	\$ 671,888
Cash & Equivalents - Restricted	-	-	-	-	-	-	149,134	149,134
Receivables:								
Accounts	-	-	-	-	-	-	-	324
Special Assessments	-	-	-	-	-	-	-	32,237
TOTAL ASSETS	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 26,402</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 173,544</u>	<u>\$ 149,134</u>	<u>\$ 853,583</u>
LIABILITIES:								
Due to Other Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 324
Deferred Revenue	-	-	-	-	-	-	-	32,237
TOTAL LIABILITIES	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>32,561</u>
FUND BALANCES:								
Reserved:								
Retiree BC/BS	-	-	-	-	-	-	-	240,539
Termination Liability	-	-	-	-	-	-	-	106,544
Perpetual Care	-	-	-	-	-	-	149,134	149,134
Debt Service	-	-	26,402	-	-	-	-	88,497
Capital Projects	-	-	-	-	-	173,544	-	173,544
Unreserved:								
Undesignated	-	-	-	-	-	-	-	62,764
TOTAL FUND BALANCES	<u>-</u>	<u>-</u>	<u>26,402</u>	<u>-</u>	<u>-</u>	<u>173,544</u>	<u>149,134</u>	<u>821,022</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 26,402</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 173,544</u>	<u>\$ 149,134</u>	<u>\$ 853,583</u>

City of Cheboygan, Michigan

Statement of Revenues, Expenditures, and Changes in Fund Balance Nonmajor Governmental Funds For the Year Ended June 30, 2006

	Special Revenue Funds				Debt Service Funds				
	Cemetery	Retiree BC/BS Investment Fund	PA 222 Liability	Termination Liability	1997 Water/Sewer Improvement Bonds	1997 Rural Economic Development Loan	1998 Local Street Paving Bond	1996 Street Paving Bonds	2001 Sidewalk Special Assessment Bond
REVENUES:									
Taxes	\$ -	\$ -	\$ -	\$ -	\$ 188,661	\$ 89,374	\$ -	\$ -	\$ -
Special Assessment	-	-	-	-	-	-	-	-	8,842
Charges for Services	8,600	-	-	-	-	-	-	-	-
Interest	-	5,094	1,395	2,212	2,058	1,326	-	-	484
Other Revenue	200	-	-	11,410	-	-	-	-	-
TOTAL REVENUES	8,800	5,094	1,395	13,622	190,719	90,700	-	-	9,326
EXPENDITURES:									
General Government	65,542	103,875	3,331	-	-	-	-	-	-
Capital Outlay	-	-	-	-	-	-	-	-	-
Debt Service	-	-	-	-	355,981	107,990	29,499	29,420	6,971
TOTAL EXPENDITURES	65,542	103,875	3,331	-	355,981	107,990	29,499	29,420	6,971
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(56,742)	(98,781)	(1,936)	13,622	(165,262)	(17,290)	(29,499)	(29,420)	2,355
OTHER FINANCING SOURCES (USES):									
Operating Transfers In	56,322	89,750	7,500	-	-	-	29,499	29,420	-
Proceeds of Refunding Bonds	-	-	-	-	2,705,000	-	-	-	-
Payment to Refunded Bond Escrow Agent	-	-	-	-	(2,605,000)	-	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	56,322	89,750	7,500	-	100,000	-	29,499	29,420	-
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	(420)	(9,031)	5,564	13,622	(65,262)	(17,290)	-	-	2,355
FUND BALANCES, JULY 1	420	249,570	57,200	92,922	68,432	51,297	-	-	22,563
FUND BALANCES, JUNE 30	\$ -	\$ 240,539	\$ 62,764	\$ 106,544	\$ 3,170	\$ 34,007	\$ -	\$ -	\$ 24,918

City of Cheboygan, Michigan

Statement of Revenues, Expenditures, and Changes in Fund Balance Nonmajor Governmental Funds For the Year Ended June 30, 2006

	Debt Service Funds			Capital Project Funds			Permanent Fund	
	2001 Sidewalk General Obligation Bond	2002 Transportation Bond	2004 General Obligation Bond	2001 Sidewalk Improvement	2002 Street Construction	Lincoln Bridge Replacement	Cemetery Perpetual Care	Totals
REVENUES:								
Taxes	\$ -	\$ -	\$ 99,244	\$ -	\$ -	\$ -	\$ -	377,279
Special Assessment	-	-	-	-	-	-	-	8,842
Charges for Services	-	-	-	-	-	-	-	8,600
Interest	-	-	1,593	1	2	9,078	2,137	25,380
Other Revenue	-	-	-	-	-	-	1,700	13,310
TOTAL REVENUES	-	-	100,837	1	2	9,078	3,837	433,411
EXPENDITURES:								
General Government	-	-	-	-	-	-	-	172,748
Capital Outlay	-	-	-	956	2,763	269,384	-	273,103
Debt Service	12,698	40,468	93,873	-	-	-	-	676,900
TOTAL EXPENDITURES	12,698	40,468	93,873	956	2,763	269,384	-	1,122,751
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(12,698)	(40,468)	6,964	(955)	(2,761)	(260,306)	3,837	(689,340)
OTHER FINANCING SOURCES (USES):								
Operating Transfers In	12,698	40,468	-	-	-	-	-	265,657
Proceeds of Refunding Bonds	-	-	-	-	-	-	-	2,705,000
Payment to Refunded Bond Escrow Agent	-	-	-	-	-	-	-	(2,605,000)
TOTAL OTHER FINANCING SOURCES (USES)	12,698	40,468	-	-	-	-	-	365,657
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	-	-	6,964	(955)	(2,761)	(260,306)	3,837	(323,683)
FUND BALANCES, JULY 1	-	-	19,438	955	2,761	433,850	145,297	1,144,705
FUND BALANCES, JUNE 30	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 26,402</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 173,544</u>	<u>\$ 149,134</u>	<u>\$ 821,022</u>

City of Cheboygan, Michigan

Combining Balance Sheet Component Unit June 30, 2006

	Downtown Development Authority	Adjustments	Statement of Net Assets
ASSETS:			
Cash & Equivalents - Unrestricted	\$ 290,997	\$ -	\$ 290,997
Prepaid Expense	750	-	750
Capital Assets not being depreciated	-	183,865	183,865
TOTAL ASSETS	291,747	183,865	475,612
LIABILITIES:			
Accounts Payable	\$ 3,085	\$ -	\$ 3,085
Accrued Liabilities	998	-	998
TOTAL LIABILITIES	4,083	-	4,083
FUND BALANCE:			
Unreserved	287,664	(287,664)	-
TOTAL LIABILITIES & FUND BALANCE	\$ 291,747		
NET ASSETS:			
Invested in capital assets		183,865	183,865
Unrestricted		287,664	287,664
Total net assets		\$ 471,529	\$ 471,529

City of Cheboygan, Michigan

Statement of Revenues, Expenditures, and Changes in Fund Balance and Statement of Activities Component Unit June 30, 2006

	Downtown Development Authority	Adjustments	Statement of Net Assets
REVENUES:			
Taxes	\$ 183,594	\$ -	\$ 183,594
Interest	4,398	-	4,398
Other Revenue	11,559	-	11,559
TOTAL REVENUES	199,551	-	199,551
EXPENDITURES:			
Public Works	122,075	(16,700)	105,375
TOTAL EXPENDITURES/EXPENSES	122,075	(16,700)	105,375
Change in fund balance/net assets	77,476	16,700	94,176
Fund balance/net assets beginning of year	210,188	167,165	377,353
Fund balance/net assets end of year	<u>\$ 287,664</u>	<u>\$ 183,865</u>	<u>\$ 471,529</u>

Report on Compliance



ANDERSON, TACKMAN & COMPANY, PLC
CERTIFIED PUBLIC ACCOUNTANTS

KINROSS OFFICE

PHILLIP J. WOLF, CPA, PRINCIPAL
SUE A. BOWLBY, CPA, PRINCIPAL
KENNETH A. TALSMAN, CPA, PRINCIPAL

DEANNA J. MAYER, CPA

MEMBER AICPA
DIVISION FOR CPA FIRMS

MEMBER MACPA

OFFICES IN
MICHIGAN & WISCONSIN

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Honorable Mayor and Members
of the City Council
City of Cheboygan, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Cheboygan, Michigan as of and for the year ended June 30, 2006, which collectively comprise the City of Cheboygan, Michigan's basic financial statements and have issued our report thereon, dated September 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Cheboygan, Michigan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Honorable Mayor and Members
of the City Council

Compliance and Other Matters

As part of obtaining reasonable assurance about whether City of Cheboygan, Michigan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standard*.

This report is intended solely for the information and use of the Mayor, City Council, Management, federal awarding agencies, pass-through entities, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.



Anderson, Tackman & Company, PLC
Certified Public Accountants

September 7, 2006



ANDERSON, TACKMAN & COMPANY, PLC
CERTIFIED PUBLIC ACCOUNTANTS

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MEMBER MACPA

OFFICES IN
MICHIGAN & WISCONSIN

REPORT TO MANAGEMENT

To the Honorable Mayor
and City Council
City of Cheboygan, Michigan

We have audited the basic financial statements of the City of Cheboygan, Michigan for the year ended June 30, 2006, and have issued our report thereon dated September 7, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of City of Cheboygan. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of City of Cheboygan's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City of Cheboygan are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We noted no transactions entered into by the City of Cheboygan during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that the future events affecting them may differ significantly from those expected.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City of Cheboygan's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the City of Cheboygan, either individually or in the aggregate, indicate matters that could have a significant effect on the City of Cheboygan's financial reporting process.

Disagreement with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultation with Other Independent Accountants

In some cases, management may decide to consult with other accountants about accounting and auditing matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City of Cheboygan's financial statements or a determination of the type of auditors' opinion to be expressed on those statements, our professional standards require the consulting accountant to check with us as to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City of Cheboygan's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in the performance of our audit.

Comments and Recommendations

941 Quarterly Federal Tax Return

In our tests of the payroll we noted that the total gross wages on the 941 Quarterly Federal Tax Return for three quarters included the deferred compensation, deferred retirement and cafe' plan and one quarter did not include these items. It is recommended the first line of the 941 Quarterly Federal Tax Return include only taxable wages and exclude any pre-tax items for federal income tax purposes. The 941 Quarterly Federal Tax Return should also be completed in a consistent manner.

City Appropriations

During the review of City Appropriations, it was noted the City appropriated monies to a non-profit organization without a written contract outlining the uses of the monies. It is recommended the City have a written contract with all non-profit organizations prior to disbursing City Appropriations, or that the City defines the governmental purpose of the appropriations. Also, an audited or reviewed financial statement should be obtained to assure funds are spent accordingly. Contributions to a non-profit agency can be a violation of state law if they do not provide allowed services.

GASB Statement 45 – Accounting and Financial Reporting By Employers for Post-Employment Benefits Other Than Pensions

In June 2004, the GASB issued Statement 45, which establishes standards for the measurement, recognition, and display of other post-employment benefits (OPEB) expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. OPEB includes post-employment healthcare as well as other post-employment benefits such as life insurance.

The Statement is implemented in three phases, which requires the City implement the Statement for the year ended June 30, 2010. GASB Statement 45 impacts the future accounting of post-employment health insurance costs as it relates to the amount the City will be required to fund these benefits. The City will be required by governmental generally accepted accounting principles to pay the current cost of providing those benefits as well as an amount needed to fund a portion of the unfunded liability relating to the post-employment health benefit. The unfunded liability will be required to be actuarially determined and will be amortized over a period likely not to exceed thirty years. The methods used as part of Statement 45 are similar to those currently used to determine required contribution rates for defined benefit pension plans.

The City Council as well as Management should begin to consider the impact of GASB Statement 45 prior to the required implementation date.

Conclusion

This information is intended solely for the use of the Mayor, City Council, and management of the City of Cheboygan and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Anderson Tackman & Co., PLC".

Anderson, Tackman & Company, PLC
Certified Public Accountants

September 7, 2006